

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

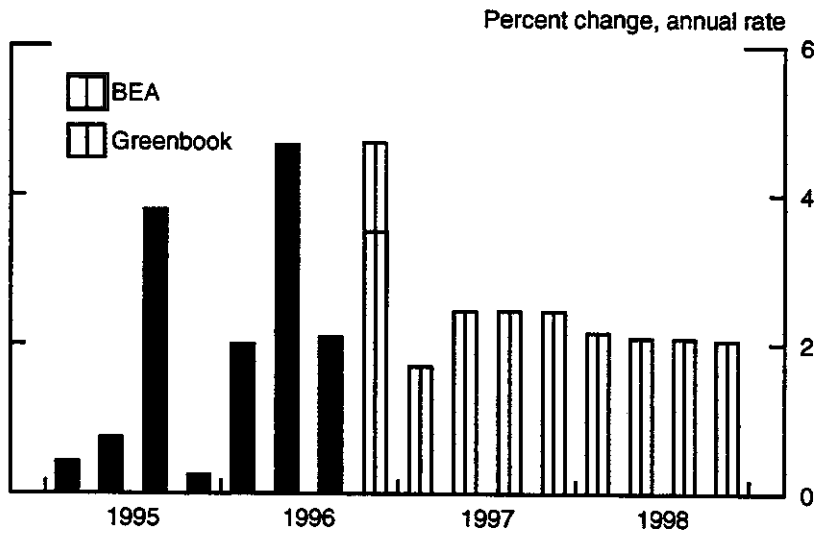
*Material for
Staff Presentation to the
Federal Open Market Committee*

February 4, 1997

Chart 1

Forecast Overview

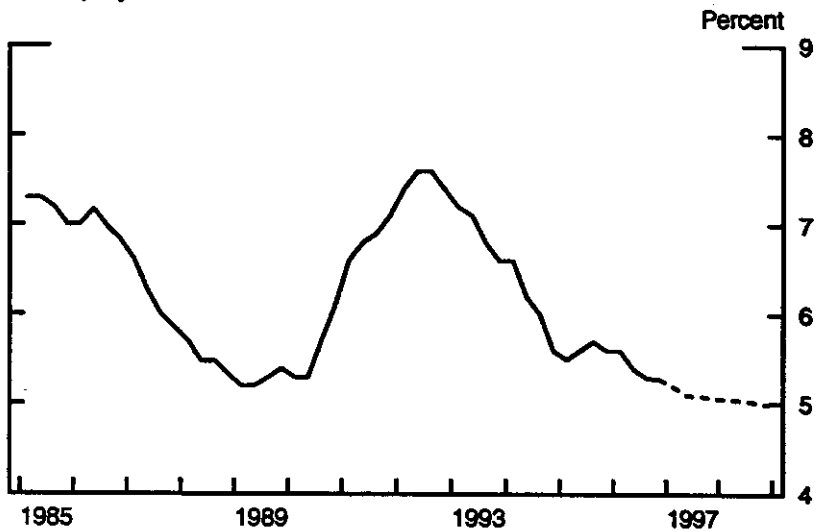
Real Gross Domestic Product



Q4/Q4 Percent Change

1995	1.3
1996	3.4 (3.1 GB)
1997	2.3
1998	2.1

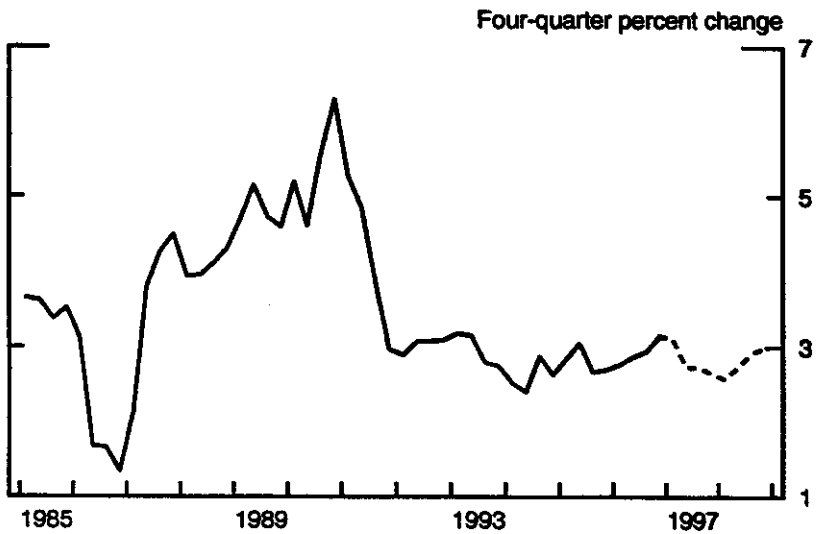
Unemployment Rate



Q4 Average

1995	5.6
1996	5.3
1997	5.1
1998	5.0

Consumer Price Index



Q4/Q4 Percent Change

1995	2.7
1996	3.1
1997	2.6
1998	3.0

Policy Assumptions

Monetary Policy:

- Federal funds rate remains at 5-1/4 percent.
- Probably implies small decline in real short-term rate.

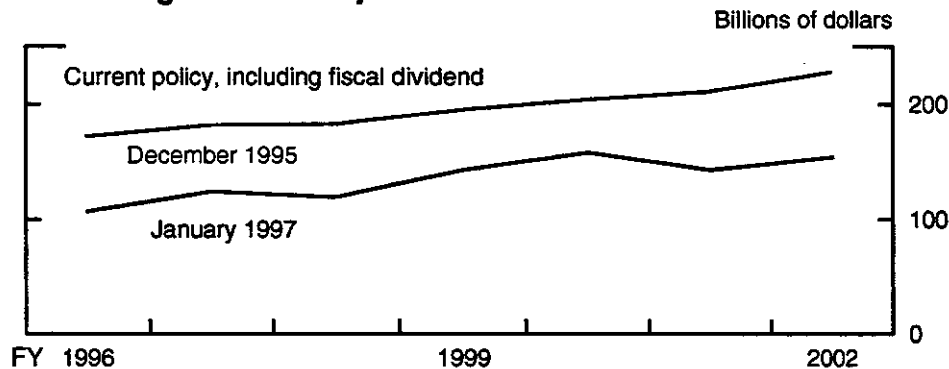
Fiscal Policy:

- No balanced budget amendment.
- Agreement on a plan to balance federal budget by FY2002.
- Implies on-going, moderate fiscal restraint.

Why budget deal this year, after last year's failure?

- Two sides were not far apart when negotiations broke down last year.
- Task smaller now, given revised budget outlook.

CBO Budget Deficit Projections



- Better setting for bipartisan action: Congressional GOP learned political advantages of compromise, while President says balancing budget is a top priority.

But it is not a sure thing

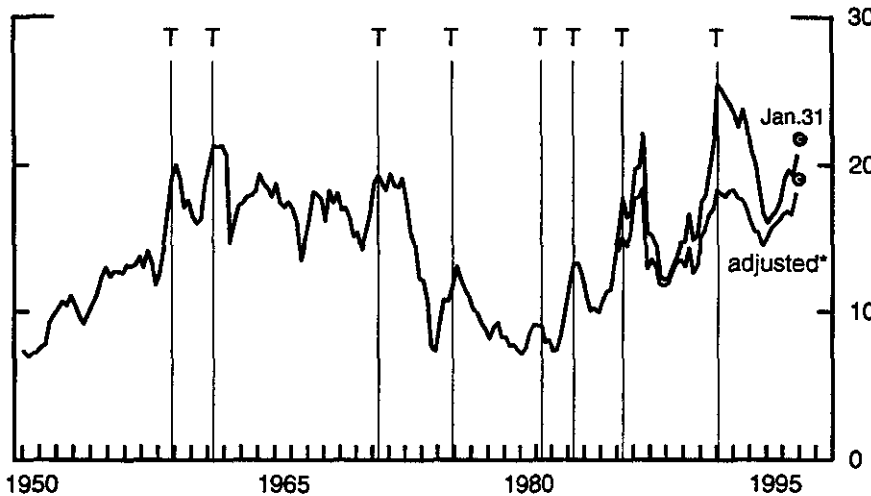
- Partisan tensions have not disappeared.
- COLA adjustment is politically scary.
- Discretionary spending already cut deeply.

Risks

- Even if accomplished on paper, could involve heavy use of gimmicks.
- Risks clearly biased toward less fiscal restraint than we have assumed.

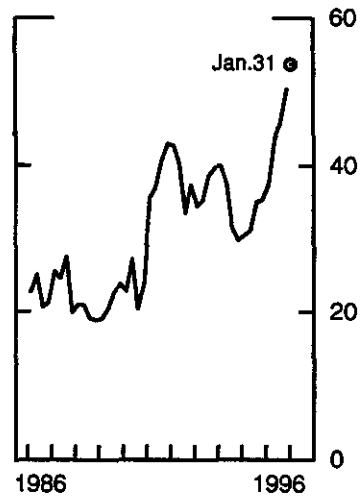
Financial Market Euphoria

Price-Earnings Ratio - S&P 500



* Source: Goldman Sachs T=Trough in earnings

P-E Ratio - NASDAQ

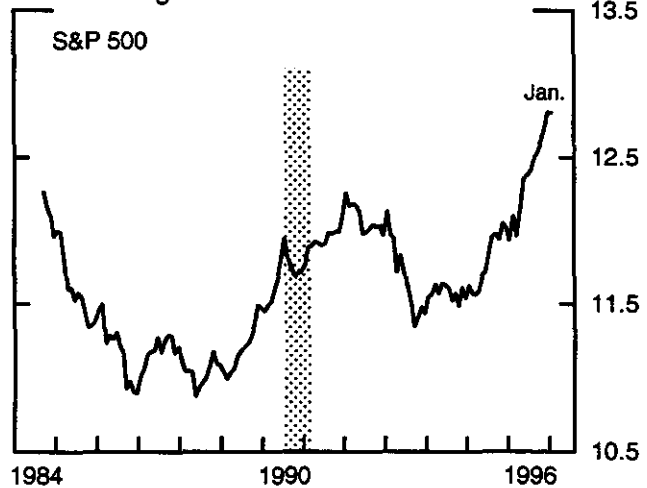


Inflation and P-E Ratios*

CPI	Average S&P 500 P-E
Less than 3.5%	18.3
3.5% - 4.5%	14.8
4.5% - 5.5%	14.8
5.5% - 6.5%	13.9
6.5% - 7.5%	9.9
Greater than 7.5%	8.9

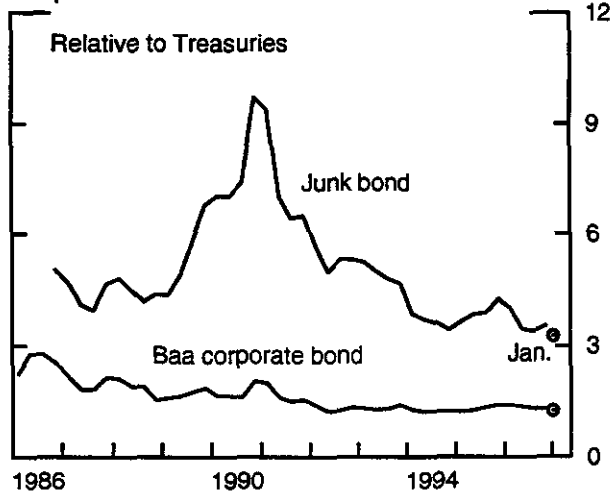
* For the period 1950-1996.

Analysts' Expectations for Three-to-Five Year Earnings Growth

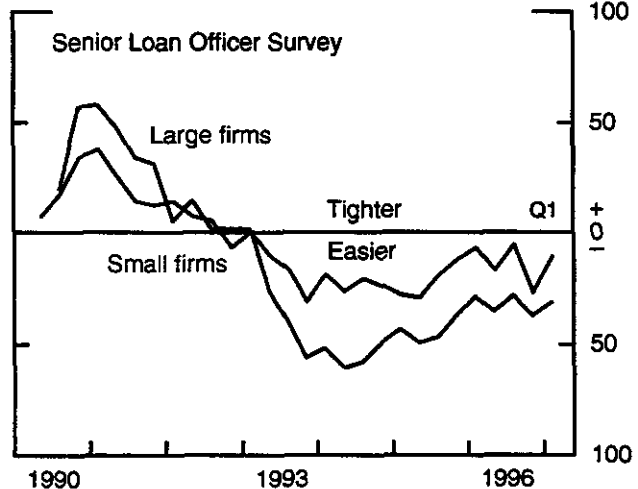


Source: I/B/E/S.

Risk Premia on Corporate Bonds

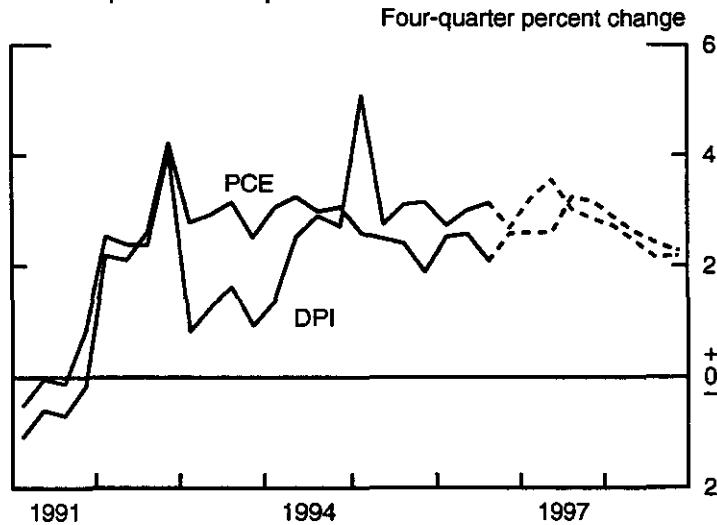


Rate Spreads on Business Loans at Banks



Sectoral Summary

Consumption and Disposable Income



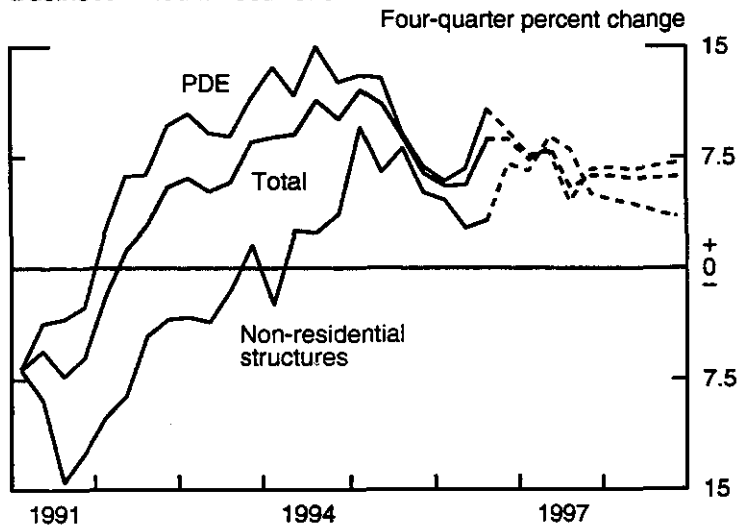
Near-term pluses:

Income growth has been strong.
Wealth up sharply.
Sentiment high.

On-going and future minuses:

Forecast anticipates only modest further rise in stock prices this year.
Wealth/income declines in 1998.
Debt burdens and tighter credit card lending.

Business Fixed Investment



Financial market conditions favorable.

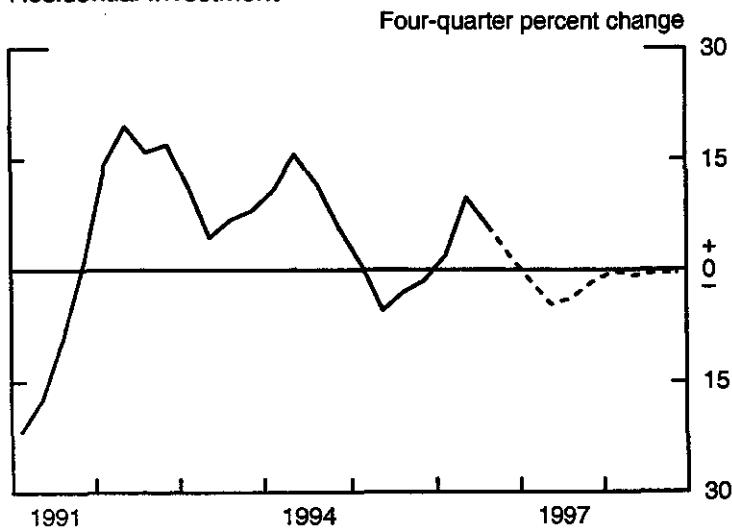
Internal cash flow growth slackening.

Declining prices, technological advances will continue to drive gains in computers, communications equipment.

Other PDE flat.

Commercial real estate market firming; office vacancies down.

Residential Investment



Housing Starts (millions)

	'95	'96	'97	'98
Singles	1.08	1.16	1.09	1.06
Multis	.28	.31	.29	.28
Total	1.35	1.47	1.38	1.34

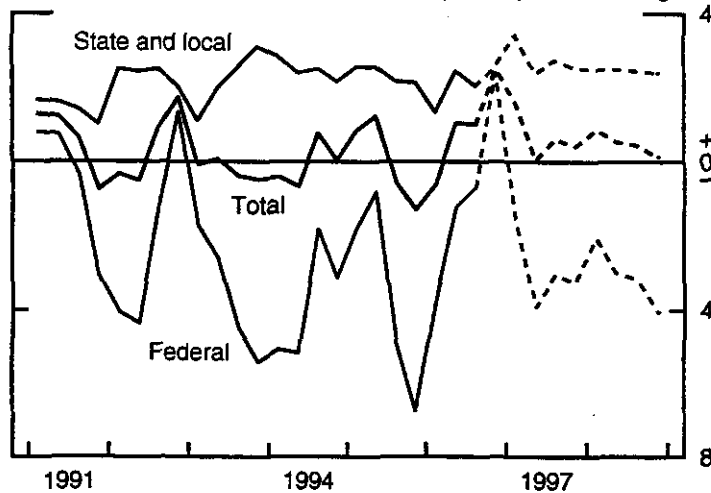
Mortgage rates in '97-'98 expected to be about the same on average as in '95-'96

Projected starts possibly high relative to demographic trends but affordability also high for singles

Chart 5

Sectoral Summary, continued

Government Consumption and Gross Investment
Four-quarter percent change



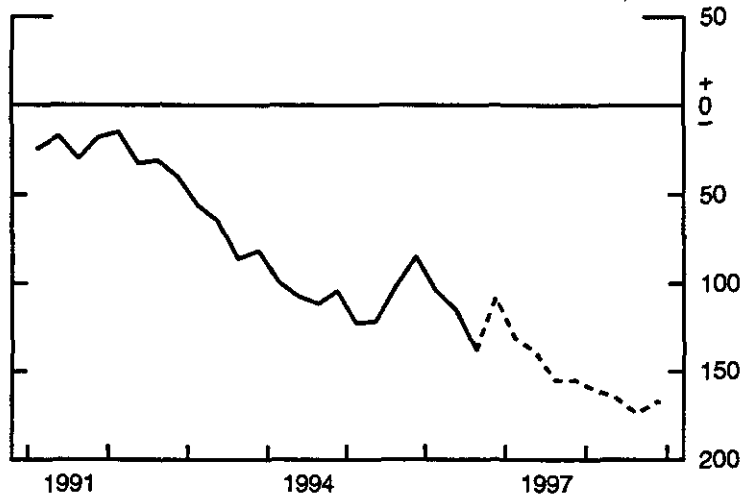
In the federal sector, shutdowns and erratic procurement have caused gyrations.

But trend lower.

State and local finances good overall.

Net Exports

Billions of 1992 dollars, saar



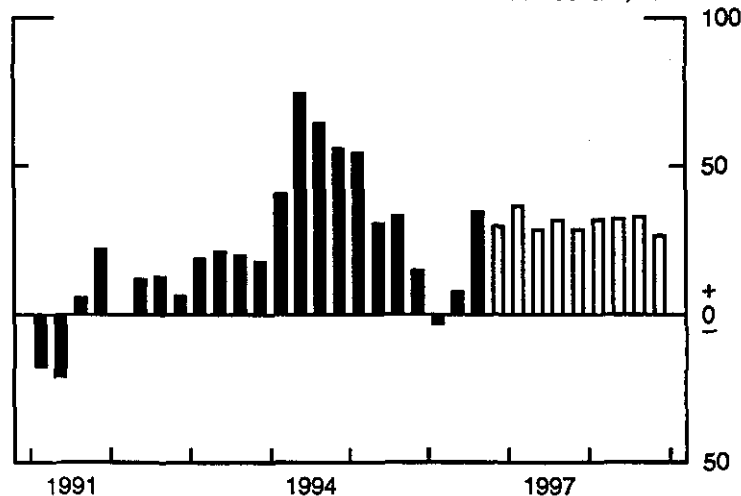
Contribution of Net Exports to GDP
Growth, in percentage points

	Q4/Q4	Annual
1995	+.3	0
1996	-.3*	-.1
1997	-.7	-.4
1998	-.2	-.3

* -.2 in BEA advance

Inventory Investment

Billions 1992 dollars, saar



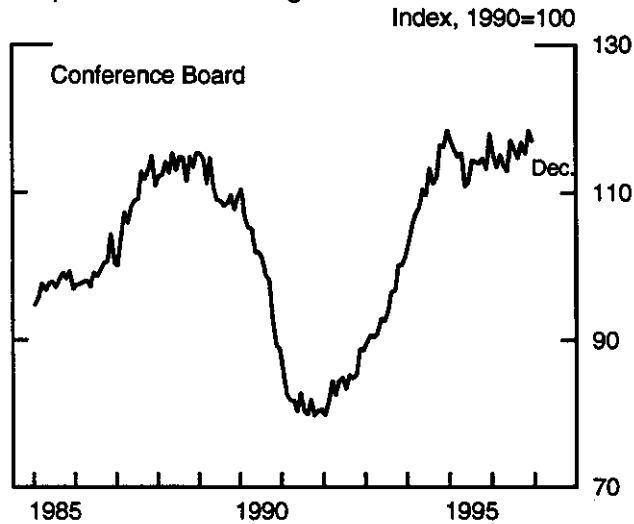
Inventory-sales ratio currently low.

Inventories expected to grow about
same pace as sales – no GDP
growth effect.

Note: All data chained (1992) dollars, based on Greenbook.

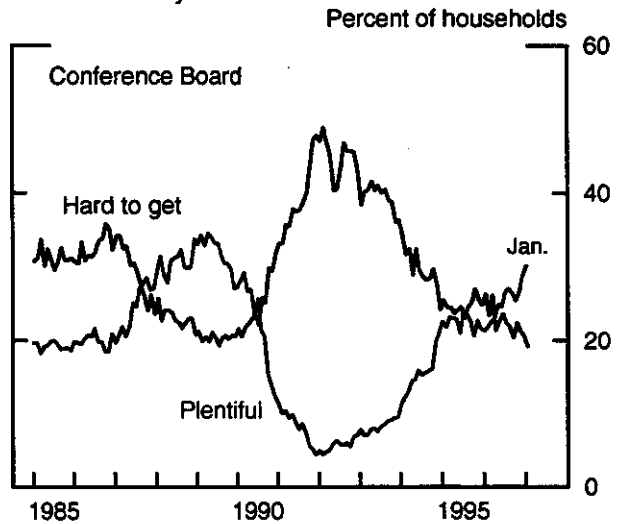
Labor Market

Help-wanted Advertising*

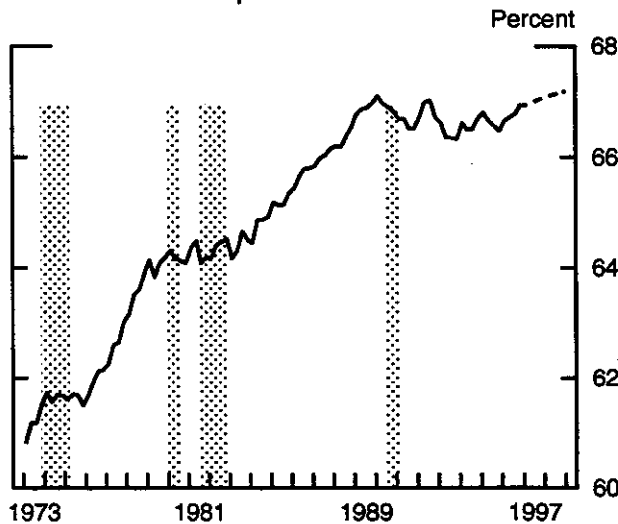


* Adjusted for newspaper consolidation and use of temps.

Job Availability

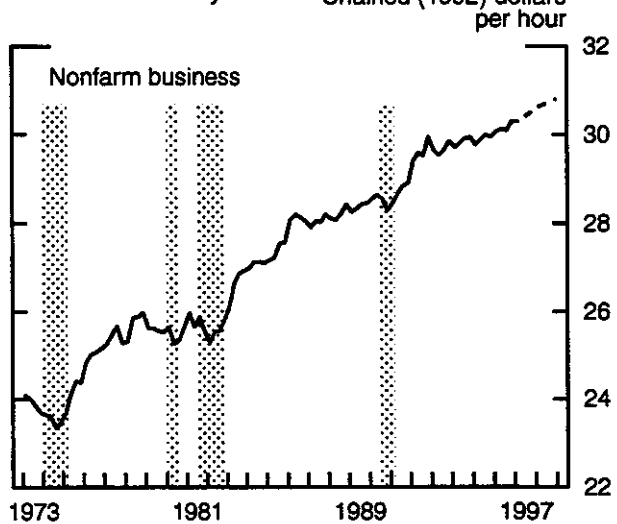


Labor Force Participation Rate*



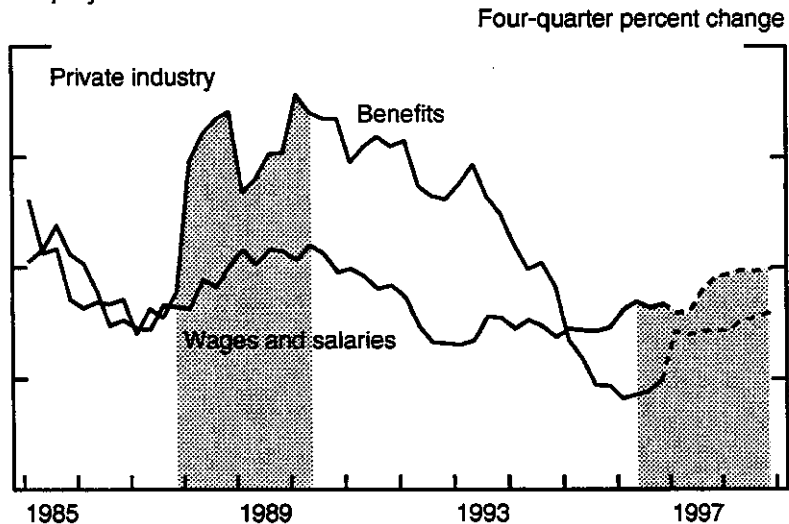
* Pre-1994 data adjusted for change in CPS.

Labor Productivity



Note: 96Q4 estimate based on BEA advance.

Employment Cost Indexes



Note: Shading indicates unemployment rate below NAIRU (6 percent in 1980s, 5.6 percent in 1990s).

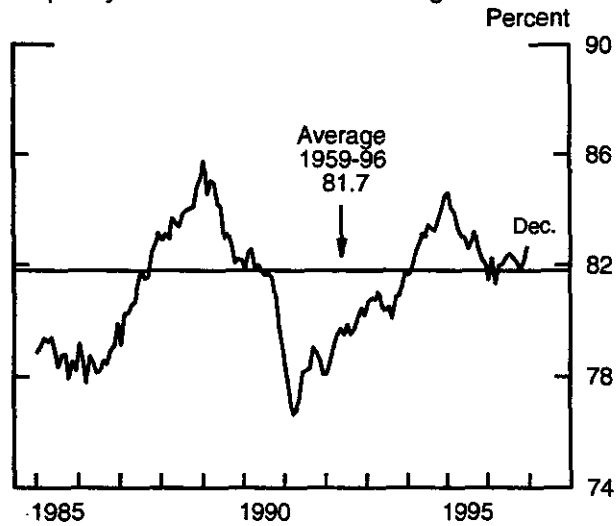
Total Compensation

1995	2.6
1996	3.1
1997	3.5
1998	3.7

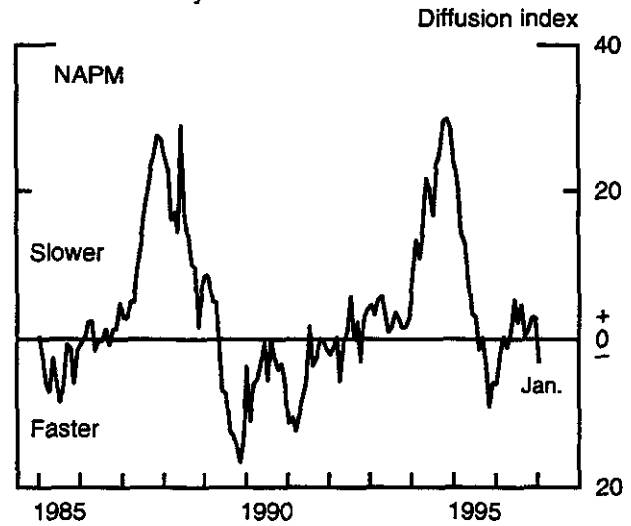
Chart 7

Prices

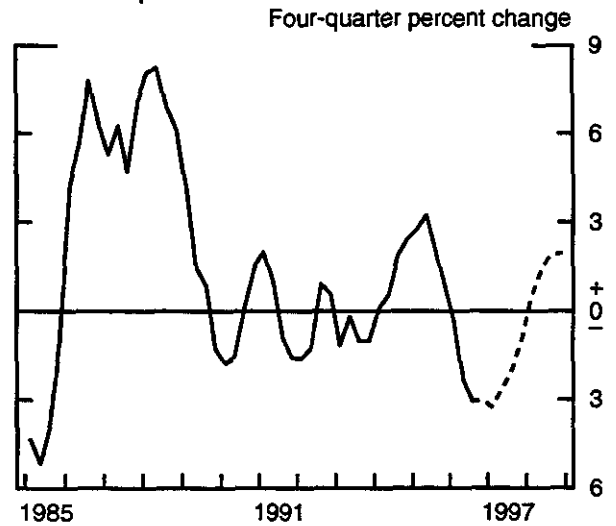
Capacity Utilization in Manufacturing



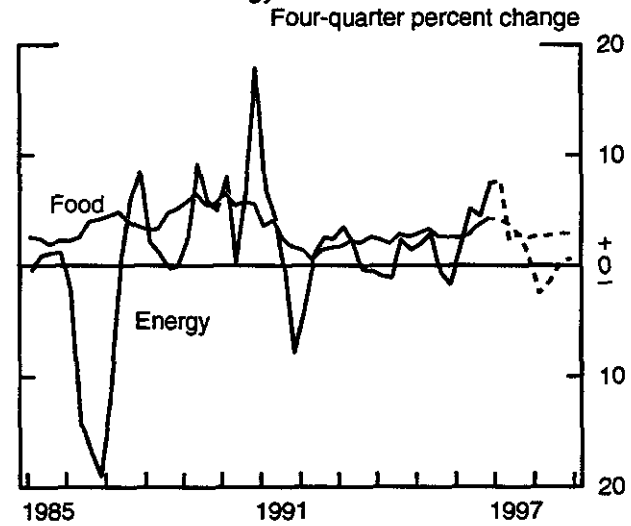
Vendor Delivery Performance



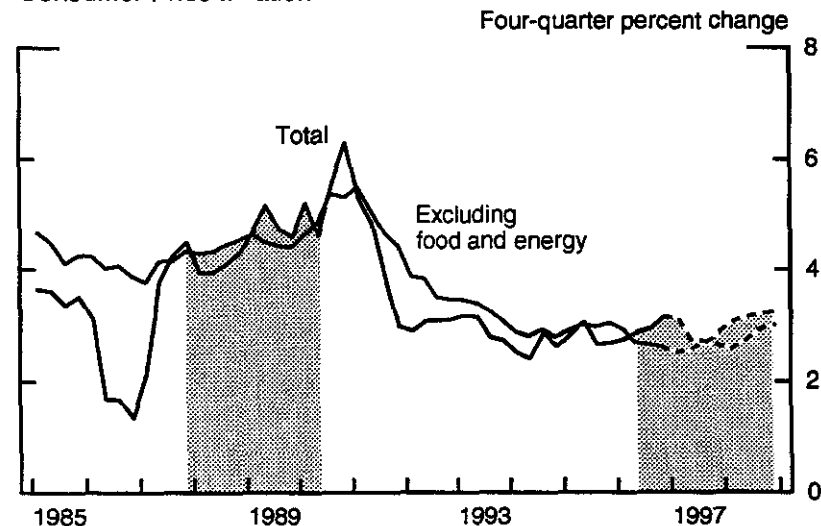
Non-oil Import Prices



CPI Food and Energy



Consumer Price Inflation



Note: Shading indicates unemployment rate below NAIRU (6 percent in 1980s, 5.6 percent 1990s).

Q4/Q4 Percent Change

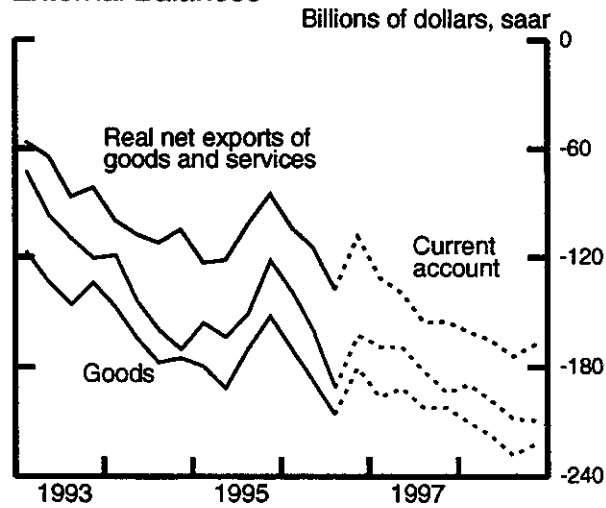
	CPI	CPIX
1995	2.7	3.0
adj.	(2.8)	(3.1)
1996	3.1	2.6
adj.	(3.3)	(2.8)
1997	2.6	2.8
adj.	(2.9)	(3.1)
1998	3.0	3.2
adj.	(3.4)	(3.6)

Note: Numbers in parentheses adjusted for technical changes in indexes since 1994.

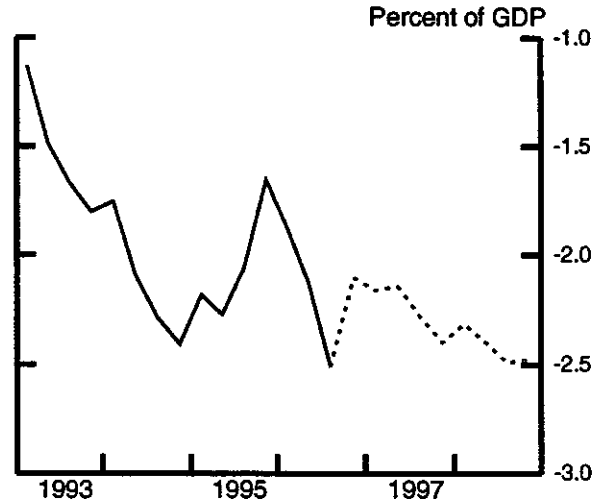
Chart 8

Forecast Summary -- External Sector

External Balances



Current Account



Major Factors in the Outlook

1. Pickup in foreign growth insufficient to outweigh U.S. growth, income elasticities, and starting point.
2. Strength of dollar damps inflation and aggregate demand in the near term.
3. Oil price declines \$5 a barrel from its recent peak.

Issues in the Outlook

1. Projection for growth abroad.
2. Risks to the dollar and in international financial markets.
3. Inflation and import prices.
4. Consequences if oil prices remain elevated.
5. Projection of weak net exports.

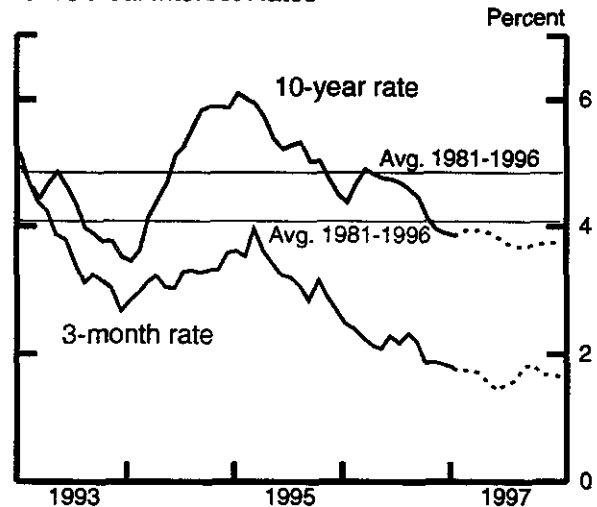
Chart 9

Foreign Outlook

Fiscal Policy: Change in Structural Balances

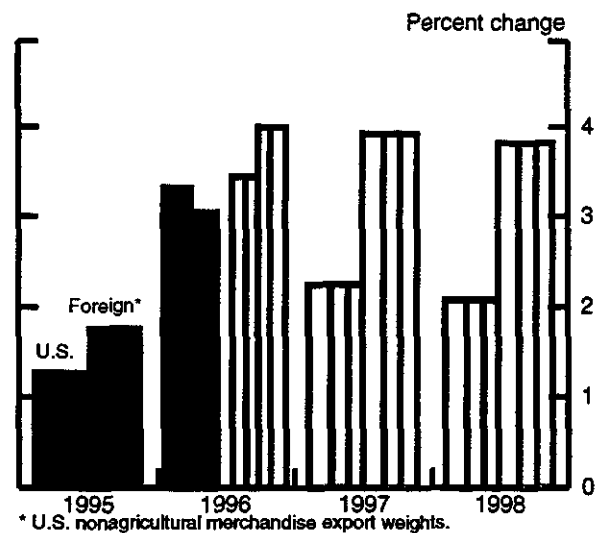
	Percent of GDP	
	Change 1995 & 1996	Change 1997 & 1998
United Kingdom	2 1/4	3/4
France	1 3/4	3/4
Germany	0	1
Italy	1 3/4	5
Japan	-2	1 3/4
Canada	3 1/2	1 1/4

G-10 Real Interest Rates



Real GDP

	Percent change, Q4 to Q4		
	1996	1997	1998
W. Europe	2.2	2.5	2.4
Canada	2.1	3.4	3.2
Japan	2.7	1.9	2.3
Mexico	4.8	4.7	4.3
Other Latin Am.	4.1	3.9	4.0
Other Asia	6.2	7.0	7.0



Forecast Comparison

	Percent change, annual			
	1997		1998	
	<u>Con- Staff <i>sensus</i>*</u>		<u>Con- Staff <i>sensus</i>*</u>	
W. Europe	2.4	2.5	2.5	2.6
Germany	2.3	2.2	2.3	2.5
Canada	3.2	3.2	3.2	2.9
Mexico	4.9	4.2	4.4	4.2
Other Latin Am.	4.4	4.5	4.0	5.2
Japan	1.9	1.4	2.1	2.3
Other Asia	6.5	6.8	7.0	7.2
Total**	3.8	3.8	3.9	4.0

Forecast Errors

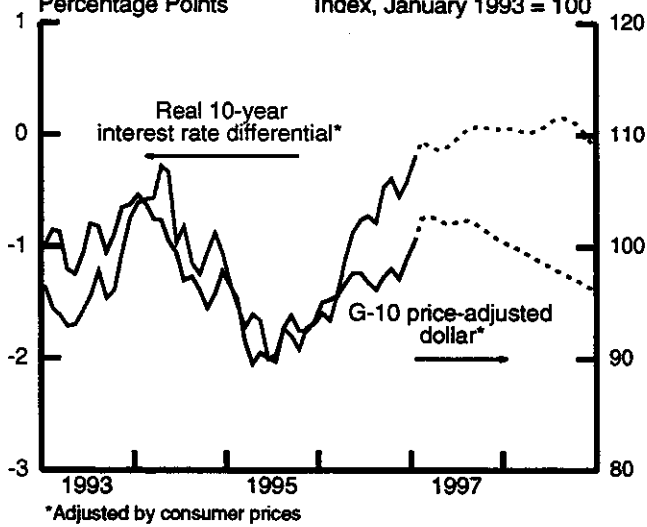
Average absolute error in global growth (1980 - 1995):	0.5 percent
<u>Risk to 1997 U.S. Forecast</u>	
Real GDP growth (Q4/Q4):	0.05 percent
Current Account (Q4):	\$6.5 billion

* Source: Consensus Economics, Inc.; Blue Chip and J.P. Morgan in 1998 for Mexico and Other Latin America.

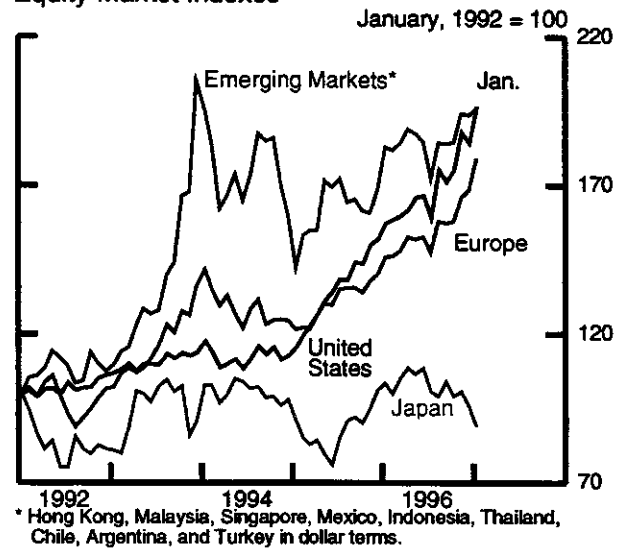
** U.S. nonagricultural merchandise export weights.

International Financial Markets

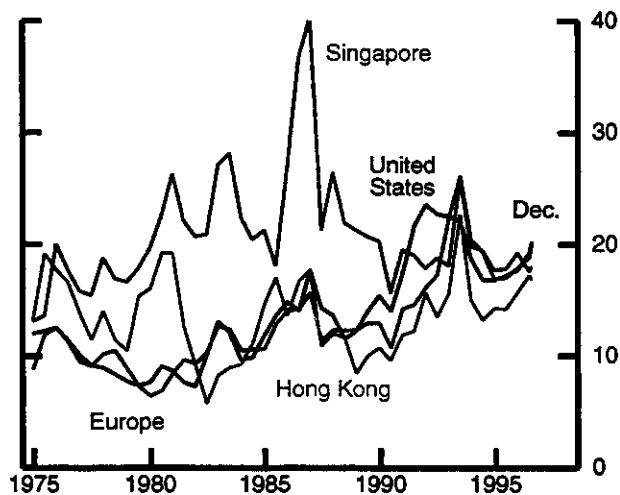
The Dollar and Real Interest Differential
Percentage Points



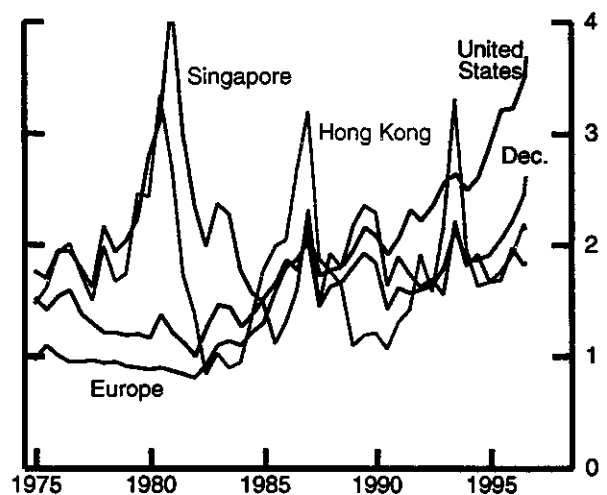
Equity-Market Indexes



Price-to-Earnings Ratios



Price-to-Book Value Ratios



Bond Yields

	Decline from 1995 Peak	10-year 2/4/97
Italy	6.57	7.17
Spain	5.95	6.73
Sweden	4.99	6.65
Canada	3.17	6.48
France	2.8	5.58
Japan	2.23	2.42
Germany	2.03	5.72
United Kingdom	1.45	7.34
United States	1.42	6.47

International Bond Issues by Developing Countries
Billions of Dollars

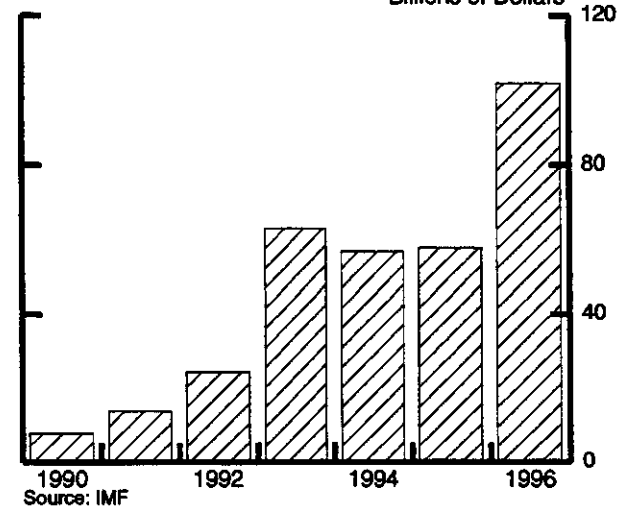
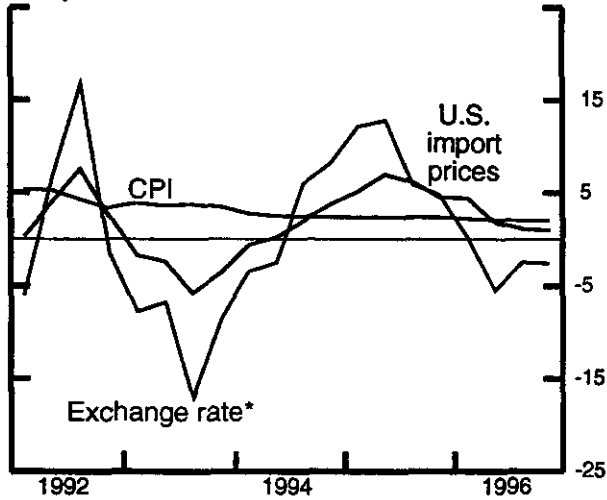


Chart 11

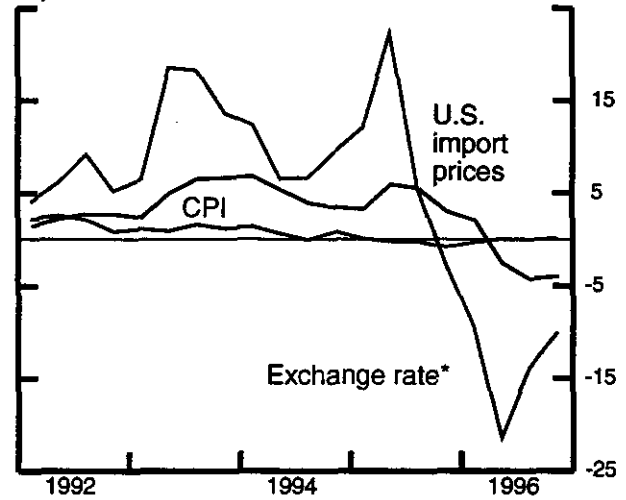
U.S. Inflation and Import Prices (Four-quarter percent change)

European Union

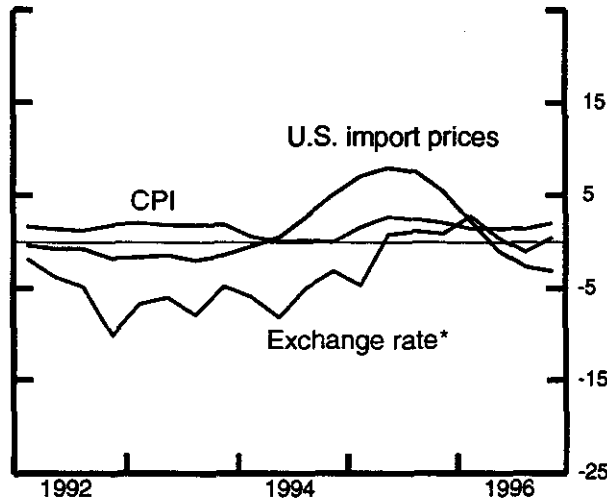


* Dollars per unit of local currency.

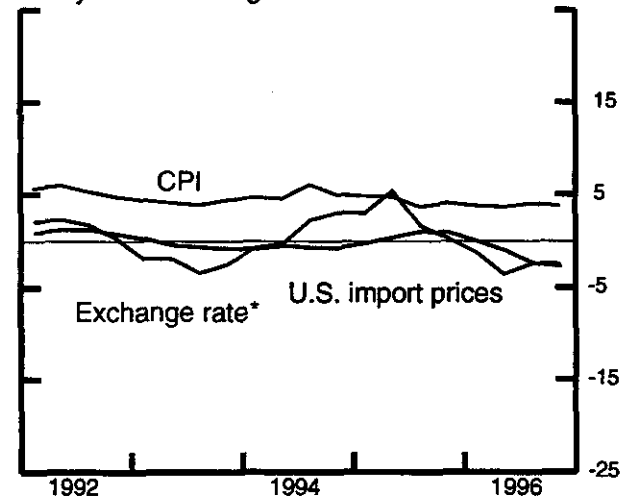
Japan



Canada

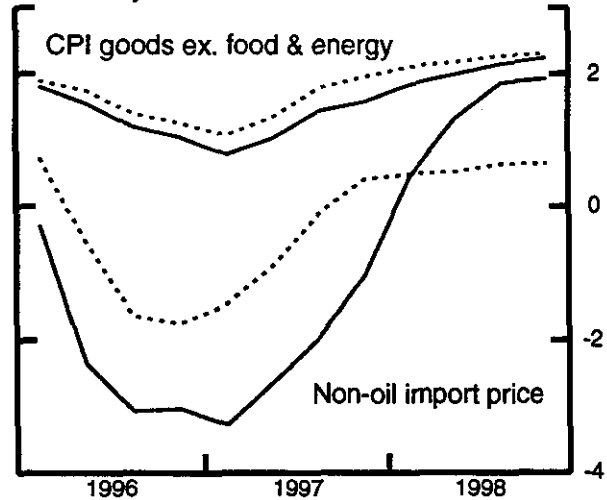


Newly Industrializing Economies **

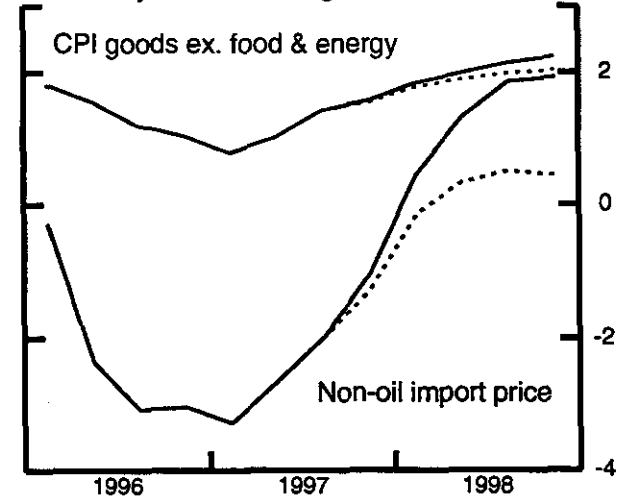


** Hong Kong, Singapore, S. Korea, Taiwan

Dollar Stays at 1995 Low

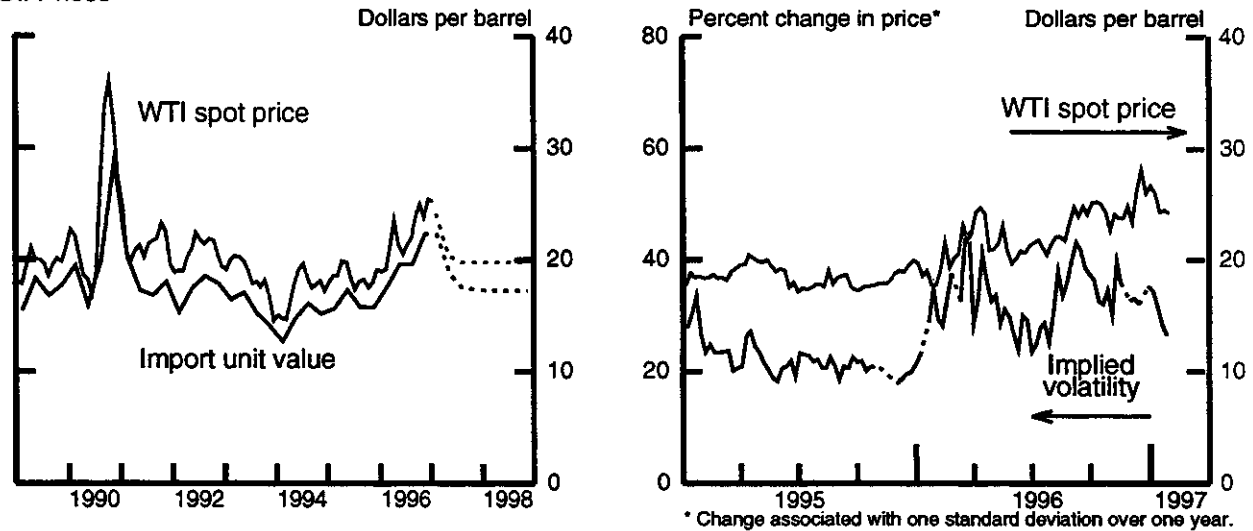


Dollar Stays at Recent High



World Oil Markets

Oil Prices



Alternative Oil Price Scenario

Baseline: Greenbook forecast extended.

Alternatives: Oil prices remain at 1996Q4 level.

Policy Assumption: Federal funds rate unchanged; foreign G-7 follow Taylor-rule type of policy.

Percent change, Q4 to Q4

	<u>1997</u>	<u>1998</u>	<u>1999</u>
U.S. PCE Inflation			
Baseline	2.2	2.6	3.1
Alternative	2.6	2.8	3.2
U.S. Real GDP			
Baseline	2.3	2.1	1.4
Alternative	2.3	2.2	1.3
Foreign G-7 Inflation*			
Baseline	1.6	1.1	1.3
Alternative	2.0	1.4	1.5
Foreign G-7 Real GDP**			
Baseline	2.8	2.7	2.5
Alternative	2.3	2.9	2.5

Billions of dollars, Q4

U.S. Current Account			
Baseline	-194	-210	-214
Alternative	-210	-215	-213

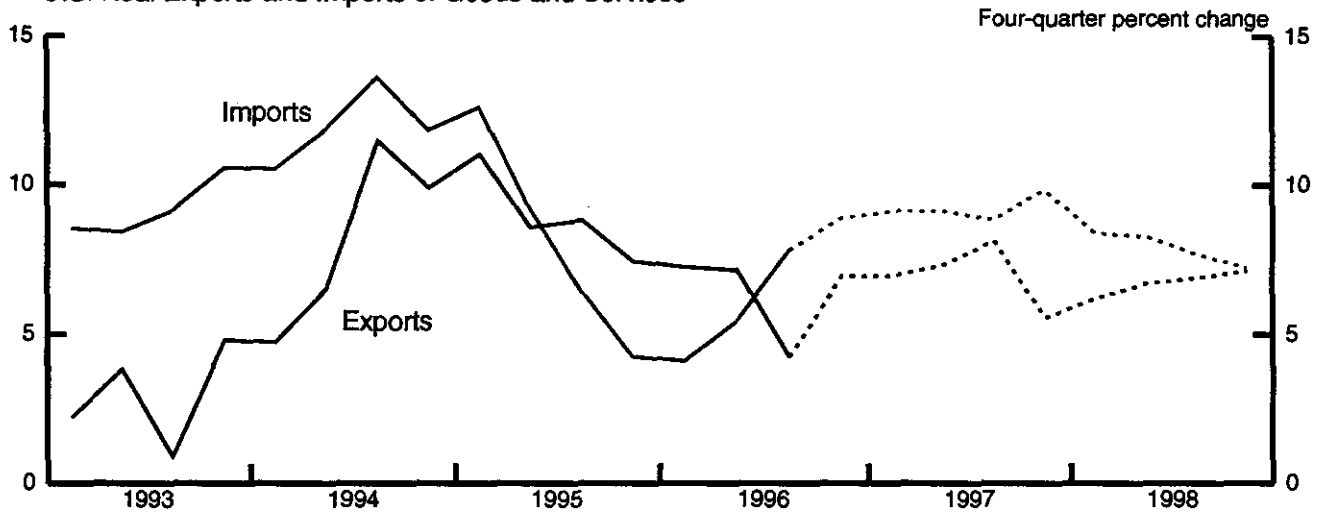
* U.S. non-oil import weights.

** U.S. nonagricultural export weights.

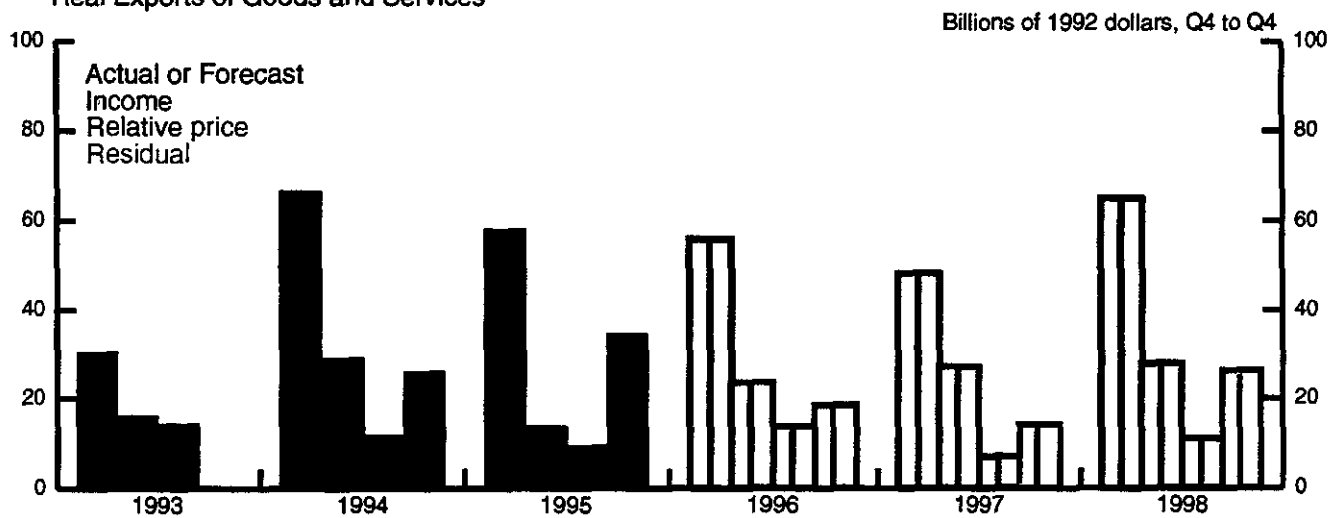
Chart 13

Prospects for Net Exports

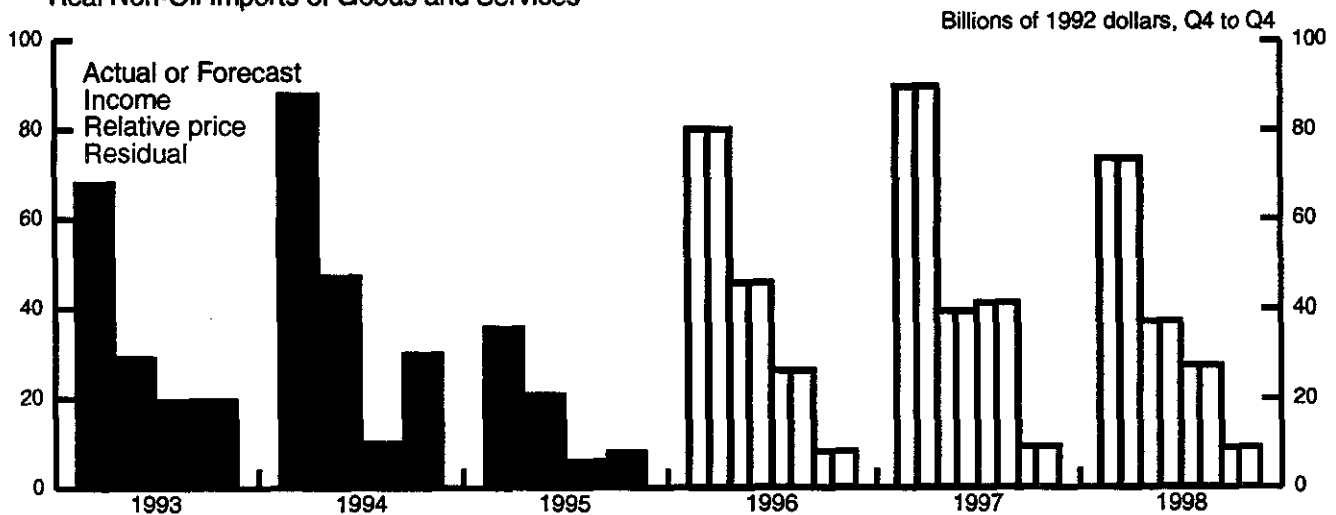
U.S. Real Exports and Imports of Goods and Services



Real Exports of Goods and Services



Real Non-Oil Imports of Goods and Services



ECONOMIC PROJECTIONS FOR 1997

	FOMC		
	Range	Central Tendency	Staff
<hr/> Percent change, Q4 to Q4 <hr/>			
Nominal GDP	4 to 5 ¹ / ₄	4 ¹ / ₂ to 4 ³ / ₄	4.6
previous estimate	4 to 5 ¹ / ₂	4 ¹ / ₄ to 5	
Real GDP	2 to 2 ¹ / ₂	2 to 2 ¹ / ₄	2.3
previous estimate	1 ¹ / ₂ to 2 ¹ / ₂	1 ³ / ₄ to 2 ¹ / ₄	
CPI	2 ³ / ₄ to 3 ¹ / ₂	2 ³ / ₄ to 3	2.6
previous estimate	2 ¹ / ₂ to 3 ¹ / ₄	2 ³ / ₄ to 3	
<hr/> Average level, Q4, percent <hr/>			
Unemployment rate	5 ¹ / ₄ to 5 ¹ / ₂	5 ¹ / ₄ to 5 ¹ / ₂	5.1
previous estimate	5 ¹ / ₂ to 6	5 ¹ / ₂ to 5 ³ / ₄	

NOTE: Central tendencies constructed by dropping top and bottom three from distribution.